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Essays

PIERCING PARETO SUPERIORITY: REAL PEOPLE AND THE OBLIGATIONS OF LEGAL THEORY

Jeffrey L. Harrison*

*There's a black man with a black cat living in a black
neighborhood
He's got an interstate running through his front yard
You know he thinks he's got it so good.¹*

I. INTRODUCTION

For over thirty years, law and economics have been viewed by many as complementing each other. The match, however, has been an uneasy one.² This is most obvious in the way that law informs economics—it really does not. This is not to say that economists do not learn by reading legal scholarship and judicial opinions.³ In addition, economic analysis has been applied to virtually every legal issue.⁴ But the question is whether anything would be different about the analytical properties of economics had it not been applied to law. This seems doubtful.

On the other hand, it seems clear that economics does inform law with respect to descriptive and empirical matters.⁵ Economics is, however, weakest in exactly the areas of inquiry where law makes its most critical contributions. Specifically, conventional law, as opposed to the “law of the jungle” or the laws

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1. JOHN COUGAR MELLENCAMP, *Pink Houses*, on UH-HUH (Riva Records 1983).

2. For a collection of essays describing this possible mismatch, see LAW AND ECONOMICS: NEW AND CRITICAL PERSPECTIVES (Robin P. Mally & Christopher K. Braun eds., 1995).

3. And, they enjoy many lucrative consulting and expert witness opportunities.

4. No footnote could hold a comprehensive list. For a baseline treatment of a multitude of issues, see RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (4th ed. 1992). Other comprehensive approaches are found in DAVID W. BARNES & LYNN A. STOUT, *CASES AND MATERIALS ON LAW AND ECONOMICS* (1992); ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* (1988); JEFFREY L. HARRISON, *LAW AND ECONOMICS IN A NUTSHELL* (1995).

5. Antitrust law is the best example of this but there are numerous other instances in which economic principles have been applied by judges. See, e.g., *Lake River Corp. v. Carborundum Co.*, 769 F.2d 1284 (7th Cir. 1985); *Union Oil Co. v. Oppen*, 501 F.2d 558 (9th Cir. 1974); *Hill v. Mobile Auto Trim, Inc.*, 725 S.W.2d 168 (Tex. 1987); *Gaito v. Auman*, 318 S.E.2d 555 (N.C. Ct. App. 1984); *Wassenaar v. Panos*, 331 N.W.2d 357 (Wis. 1983).

of microlegal systems, means the existence of a state that is constantly involved in wealth and resource redistributions or conscious decisions not to affect these redistributions. This means making rules that advantage some while disadvantaging others. Economics is woefully inadequate at providing guidance here.

To understand why economics is at a loss with respect to these matters, take a closer look at the two basic limitations of economics. Start with the assumption of rational self-interest. Does it apply in a context in which norms and principles push people to do things that seem to make no sense if self-interest is the only goal?⁶ It does not unless one makes use of "psychic income," of which there is evidently an unlimited supply.⁷ The use of "psychic income," however, in order to patch things up results in rational self-interest losing its explanatory value.⁸ To many, it is clear that the traditional market-based incentives of economics are often misplaced in the markets with which law and economics is concerned.⁹

More serious is the limitation on interpersonal comparisons of utility.¹⁰ Because economics must and does steer clear of interpersonal comparisons of utility, it really is of no help in determining when one distribution is better or worse than another. Even the use of wealth-maximization or willingness to pay does not help out here since the ability to assert oneself in the market may be quite different than the utility associated with a change in position.¹¹ Indeed, without money one's preferences are irrelevant unless they are somehow communicated through a third party.

The economist's answer to these limitations lies in the concept of Pareto notions of efficiency. For present purposes, the most interesting of these notions is Pareto Superiority. A reallocation is said to be Pareto Superior when at least one person is made better off and no one is made worse off.¹² Regardless of one's point of view as to how far a judicial system or government should go in achieving distributive fairness, everyone would seem to agree that reallocations that achieve a Pareto Superior state are desirable. This is not to say different people would not choose one Pareto Superior move over another, but simply that there would be no objections to reallocations that improve the

6. Some writers expressly exclude this type of behavior from their analysis. See Robert Cooter, *Prices and Sanctions*, 84 COLUM. L. REV. 1523, 1527 (1984); CHARLES J. GOETZ, *CASES AND MATERIALS ON LAW AND ECONOMICS* 4 (1984).

7. See FREDERIC L. PRYOR, *THE ORIGINS OF THE ECONOMY* 95, n.27 (1977).

8. As Amartya Sen puts it: "[N]o matter whether you are a single-minded egoist or a raving altruist or a class conscious militant, you will appear to be maximizing your own utility in this enchanted world..." Amartya K. Sen, *Rational Fools: A Critique of the Behavioral Foundations of Economic Theory*, 6 PHIL. & PUB. AFF. 317, 323 (1977).

9. Some of these "markets" are the markets for breach of contract, carelessness and criminal behavior. See Jeffrey L. Harrison, *Egoism, Altruism, and Market Illusions: The Limits of Law and Economics*, 33 U.C.L.A. L. REV. 1309 (1986); Kenneth G. Dau-Schmidt, *An Economic Analysis of the Criminal Law as a Preference-Shaping Policy*, 1990 DUKE L.J. 1 (1990).

10. This means the ability to compare one person's sense of loss or gain with that of another.

11. See generally Anthony T. Kronman, *Wealth Maximization as a Normative Principle*, 9 J. LEGAL STUD. 227 (1980).

12. Obviously, a reallocation is inferior (Pareto Inferior) if it makes at least one person worse off, regardless of its impact on others. Finally, an allocation is Pareto optimal if there is no allocation that can be made that does not make at least one person worse off.

position of at least one person and do not make anyone worse off. While it is clear that strict adherence to a Paretian standard means that governments can do very little,¹³ Pareto Superiority can be seen as an explanation for why private agreements are seen as both efficient and not unjust.¹⁴ They are efficient because the overall level of welfare has increased. They also seem just because all parties have consented. Pareto Superiority is one of the obvious concepts that can complement legal decision-making. Its implications extend beyond contract law, but that is the area in which its applications are most obvious.

This essay has two purposes. The first is to demonstrate that the appearance of mutual assent and Pareto Superiority are weak bases for enforcing agreements. Pareto Superiority, as unassailable as it may seem, is paper-thin and frequently based on illusions and a normatively meaningless assessment of what it means to be "better off." The approach here is one of "piercing Pareto Superiority" in order to examine the human factors that may determine whether an agreement occurs and its distributive consequences. Relative deprivation is the instrument used.¹⁵ The second purpose is to suggest that it is the obligation of legal theory to take greater account of the psychological and social factors that influence the process of agreement.

There is a subtheme that will be evident throughout. It deals with the occasional inconsistency between the relatively benign-sounding notion of cooperation, on one hand, and the conflict that occurs when one experiences a sense of injustice. The point is that efficient outcomes or reallocations, especially in the Paretian sense, require cooperation sufficient to permit exchange.¹⁶ Passivity, advantage-taking, inequality, intimidation and subtle forms of coercion can also be taken for the type of "cooperation" that is highly consistent with efficiency. On the other hand, anger, disappointment, and stubbornness may further desirable distributive outcomes. In short, there can be a conflict between the spirit or the emotions associated with seeking the end of maximizing joint utility or wealth and the spirit or emotions that accompany, or may be required to assure, a fair distribution of the gain. Indeed, to one who values fairness as much or more than efficiency, these seemingly "combative" feelings may be constructive.

II. PARETO SUPERIORITY AND DEAL MAKING

What is questionable about a standard that leaves at least one person

13. Of course, there is the possibility of agreeing in advance to a type of government that may take steps that require one to be made worse off for the benefit of others. It is possible that this type of agreement might take place behind a Rawlsian "veil of ignorance."

14. The terms "not unjust" is used here to allow for the fact that there may, depending on one's perspective, be different outcomes that would seem more just or fair.

15. There is a great deal more to be said about the importance of relative as opposed to absolute comparisons in influencing decision making. See Richard H. McAdams, *Relative Preferences*, 102 YALE L.J. 1 (1992). See also Jeffrey L. Harrison, *Class, Personality, Contract and Unconscionability*, 35 WM. & MARY L. REV. 445 (1994); Herbert Hovenkamp, *The Limits of Preference-Based Legal Policy*, 89 NW. U. L. REV. 4 (1994).

16. The inclination of people to cooperate in order to achieve joint maximization is evident in the number of exchanges that are made and has been demonstrated in some interesting experiments. See, e.g., Elizabeth Hoffman & Matthew L. Spitzer, *Entitlements, Rights and Fairness: An Experimental Examination of Subjects' Concepts of Distributive Justice* 14 J. LEGAL STUD. 259 (1985); Elizabeth Hoffman & Matthew L. Spitzer, *The Coase Theorem: Some Experimental Tests*, 25 J.L. & ECON. 73 (1982).

better off and no one worse off? The starting point is not so much what it means to be better off as it is *who* decides this. In economics the answer is fairly simple; as rational maximizers of self-interest, individuals are rendered almost incapable of doing anything that does not make them better off. How do we know what it is that makes them better off? They reveal their preferences through the choices they make.¹⁷

A great deal has already been written about just how choices and preferences are linked and whether choices reveal preferences.¹⁸ That is not the issue here. Instead, the beginning point for the analysis is to *assume* that what people do in market or other choices really *are* consistent with their preferences. In a sense, one could say that they know what they want and they get what they want. In fact, even after the contract is made or the exchange takes place, they would not desire to go back to the original state.

So what is it, under these ironclad conditions—a no-regret form of Pareto Superiority—that should give us pause when using Pareto Superiority to inform legal decisions? If law is to mean something independent of economics in the matters of exchange, agreement, or contract-making, it is to look at what makes agreement possible. There are two steps in any agreement.¹⁹ The first is discovering a potential exchange that will increase the well-being of both parties. To a great extent this is a matter of overcoming transaction costs. The second step is determining what will be viewed by both parties as a way to fairly divide the gain from the exchange.²⁰

These steps can be illustrated with the example of the “haggling yuppies.” Suppose Bob is in the market for a new car and being a proper academician sets out on a quest for a Volvo station wagon. Before he embarks on his shopping trip he, as academics often do, conducts a complete survey—probably while on university time—of all consumer literature to get an idea of what prices would be appropriate for specific models. Eventually, he locates what he considers a perfect car—side air bags, built-in child seats, tasteful color, etc.—and his research tells him that the value of that car is between \$18,000 and \$20,000. He determines that the most he is willing to pay is \$20,000. This is his reservation price. Of course, he would prefer to pay less and plans to make an initial offer of \$18,000.

Let's suppose that Jane, the potential trading partner, is somewhat desperate to sell her Volvo in order to raise money for her “summering” at the Vineyard. Consequently, she anticipates being willing to take as little \$18,000 for the car but has listed it at \$20,000. Obviously, what this creates is an opportunity for movement to a Pareto Superior state. Bob prefers the automobile to anything else he could buy with his \$20,000 and Jane prefers

17. See Paul A. Samuelson, *Consumption Theory in Terms of Revealed Preference*, 15 *ECONOMICA* (n.s.) 243 (1948).

18. See, e.g., Harrison, *supra* note 9; Mark Kelman, *Choice and Utility*, 1979 *WISC. L. REV.* 769 (1979); Amos Tversky & Richard H. Thaler, *Anomalies: Preference Reversals*, *J. ECON. PERSP.*, Spring 1990, at 201.

19. See generally Jeffrey L. Harrison, *Trends and Traces: A Preliminary Evaluation of Economic Analysis in Contract Law*, 1988 *ANN. SUR. AM. L.* 73, 95–98.

20. Any issue that must be addressed in order to consummate the exchange may be fairly called a transaction cost. The cost addressed here is associated with an internal and personal sense of fairness. It is not called a transaction cost because it goes beyond the usual search and negotiation costs.

\$18,000 to continued possession of the car.

Everything else would seem to be self-executing; the only issue is what price between \$18,000 and \$20,000 will be the selling price. Is it possible that the decision about price could undermine what appears to be a movement to a more efficient allocation? In this simple example, probably not. But what happens if Bob and Jane become real people—people with a context. Suppose there is some initial small talk before negotiating about the car and it is revealed that the car was given to Jane by her wealthy uncle. It is also revealed that Bob is a law professor and, to Jane, this translates to “greedy,” and “well-paid.” Both parties have seen the consumer information suggesting that the car has a fair market value of \$18,000 to \$20,000. Jane may feel that any price lower than \$20,000 is tantamount to a gift from her to Bob. On the other hand, Bob may feel that, given that Jane is in a hurry to sell and did not pay for the car in the first place, any price above \$18,000 is a gift from him to Jane. It may be that neither party changes his or her valuation of the car itself, but all along both desired the exchange *and* a sense of having been treated fairly. Although this particular exchange may still take place, to the extent considerations of “compensatory justice”²¹ begin to play a role, the transaction may be delayed—or the opportunity even lost.

The haggling yuppie example raises the issue of whether the quest for fairness can get in the way of efficiency.²² This question has been addressed relatively recently, and it is clear that in many circumstances people behave as though achieving a sense of fairness may be a *necessary* condition for entering into an agreement that otherwise would seem to increase their wealth.²³ The issue is illustrated by a question posed in two forms by Richard Thaler, one of the pioneers in the intriguing area of study devoted to linking economic theory to actual human behavior:

You are lying on the beach on a hot day. All you have to drink is ice water. For the last hour you have been thinking about how much you would enjoy a nice cold bottle of your favorite brand of beer. A companion gets up to go make a phone call and offers to bring back a beer from the only nearby place where beer is sold (a fancy resort hotel) [a small run-down grocery store]. He says that the beer might be expensive and so asks how much you are willing to pay for the beer. He says that he will buy the beer if it costs as much or less than the price you state. But if it costs more than the price you state he will not buy it. You trust your friend, and there is no possibility of bargaining with the (bartender) [store owner]. What price do you tell him?²⁴

21. The term “compensatory justice” is used in Michel Rosenfeld, *Contract and Justice: The Relation Between Classical Contract Law and Social Contract Theory*, 70 IOWA L. REV. 769, 780 (1985). I am not sure the term is used to mean the same thing here but it seems reasonably close. Here it is limited to a sense of being treated fairly in the context of an exchange.

22. I realize that the “psychic income” disciples will simply say that I have added an additional item—fairness or a sense of compensatory justice—to the utility functions of the parties and, therefore, their possible inability to agree just means that they were unable to find a solution that left at least one of them better off while no one was worse off. I think the point to be made is still relevant to those adopting this view although it may require an application of a little “psychic energy” to make the necessary translations.

23. Richard H. Thaler, *Mental Accounting and Consumer Choice*, 4 MARKETING SCI. 199, 206 (1985). See also RICHARD H. THALER, *THE WINNER’S CURSE: PARADOXES AND ANOMALIES OF ECONOMIC LIFE* 21–35 (1992).

24. THALER, *supra* note 23, at 21–35.

In Thaler's experiment, the median price for those who saw themselves as buying the beer from the resort was \$2.65. Those who were given the run-down store version were willing to pay a median price of \$1.50.²⁵ What this suggests is that the decision does not simply involve the exchange of a certain amount of money (and foregone alternative purchasing opportunities) for a beer but the additional element of what is a fair price.²⁶

Thaler's beer question is an example of what is called the "ultimatum game."²⁷ In its more bare-bones version it takes the form of giving a certain amount of money to one party. He or she must get the permission of another party to keep the money and this permission can be bought by making a one-time offer to the potential permission-giver of some portion of the money. If no permission is given, neither party gets to keep any of the money. Suppose the sum initially allocated is \$10.00. Presumably, the rational maximizer of self-interest would offer the permission giver one cent or some other small amount and keep \$9.99, and the permission-giver would find one cent acceptable. This would mean both parties are better off. The alternative of not granting the permission means that both parties are worse off.²⁸ Yet, typically more than the bare minimum is offered and offers that are close to the bare minimum are often rejected.²⁹ In short, parties are willing to sacrifice an opportunity to be "better off" in a material sense in order to avoid being treated in a way that they perceive as unfair. One way of putting it is that they are willing to pay for fairness by passing up material gain.

There are two ways to explain the outcomes of these experiments. One is to say that potentially Pareto Superior outcomes are thwarted by the selfishness and irrationality of the parties; they cut off their noses to spite their faces. A second view is that a sense of "compensatory justice" is likely to be part of an individual's utility function and exchanges that are rejected are those that would not have increased utility although they might have increased material well-being. Regardless of how it is viewed, it seems clear that people differ in what they expect or find acceptable in an exchange, and it is important that two parties be compatible in this regard for the bargain to take place.

For example, in the case of the haggling yuppies, the car may or may not be sold. It depends on whether, despite their different views of the circumstances, they can locate some area of distributive compatibility. One possibility is that they will not find a price that both find acceptable due to both of their high expectations about what constitutes being treated fairly. On the other hand, they may. Either way, it is hard to view the issue as one that law should account for.

But consider another case—this time the real case of *Jones v. Star Credit*

25. Thaler, *supra* note 23, at 206.

26. *Id.* at 207. See also Daniel Kahneman et al., *Fairness and the Assumptions of Economics*, 59 J. BUS. S285 (1986) [hereinafter Kahneman et al., *Fairness and the Assumptions of Economics*]; Daniel Kahneman et al., *Fairness as a Constraint on Profit Seeking: Entitlements in the Market*, 76 AMER. ECON. REV. 728 (1986) [hereinafter Kahneman et al., *Fairness as a Constraint on Profit Seeking*]; Richard H. Thaler, *Anomalies: The Ultimatum Game*, J. ECON. PERSP., Fall 1988, at 195.

27. See Werner Güth et al., *An Experimental Analysis of Ultimatum Bargaining*, 3 J. ECON. BEHAV. & ORG. 367 (1982).

28. For a survey of variations on this theme, see THALER, *supra* note 23.

29. See Kahneman et al., *Fairness and the Assumptions of Economics*, *supra* note 26, at S288-92.

*Corp.*³⁰ Here the plaintiffs, characterized by the court as “welfare recipients,”³¹ purchased a home freezer for \$900 from Your Shop At Home Service, Inc. When this was added to various other credit and insurance charges, the total price was \$1234.80. According to the appellate court, it had been established at trial that the freezer had a “maximum retail value of \$300.”³² If one adopts the standard notion of Pareto Superiority, it is hard not to conclude that the “cooperation” between the Joneses and Your Shop At Home Service, Inc. had a desired outcome. Unless expressed preferences are misleading, the Joneses preferred the freezer to whatever else could be purchased with \$1200 and the Your Shop At Home preferred the money to keeping the freezer. This is not to say that the Joneses would not have preferred to buy the freezer at a lower price, but that is a different issue and no different from the fact that Your Shop At Home would have preferred to sell the freezer for \$2,000.

These are distributive issues and achieving a different distributive outcome in this context would have required the Joneses to be less “cooperative.” One might wonder whether either of the battling yuppies would have been as “cooperative” as the Joneses. Of course, to say the parties “cooperated” seems out of place in this context and the court did, without finding that there was any fraud involved, find the bargain inconsistent with the “moral sense of the community.”³³

In another example, *Allied Van Lines, Inc. v. Bratton*,³⁴ Bratton, a woman, contracted with Allied Van Lines to have her household goods shipped. When the movers—men—picked up her possessions, she was asked to sign a bill of lading limiting the carriers’ liability to \$1.25 per pound. After the property was destroyed, she sought not to be limited to the \$1.25 per pound under the theory of “mistake” and “lack of assent.”³⁵ The trial court held for Bratton and was reversed by the Supreme Court of Florida. Most interesting is a short excerpt of trial testimony concerning the circumstances of Bratton’s “assent.”

Q: Did anyone prevent you or stop you from reading the bill of lading?

A: No.

Q: Did anyone say anything to you that you took to be an inducement not to read it?

A: No. Like I said before, the house was really cold; and the men were tired. They were in a hurry to get out.³⁶

Here we have another version of “cooperation” leading to a Pareto Superior outcome. Again, there seems to be little duress in a traditional sense, but there is an obvious discomfort with raising an issue with the movers that might result in a different distributive outcome. This could be the result of any number of factors, but the easiest to spot is that she prefers to be accommodating. In fact, one could say that the accommodations of others or the avoidance of conflict is something from which she derives utility. It is not clear

30. 298 N.Y.S.2d 264 (Sup. Ct. 1969).

31. *Id.* at 265. The court also suggests that the plaintiffs were “poor and illiterate.” *Id.* at 266.

32. *Id.* at 265.

33. *Id.* at 266.

34. 351 So. 2d 344 (Fla. 1977).

35. *Id.* at 346.

36. *Id.* at 346 n.3.

that it is accurate to attribute this to gender,³⁷ but what does seem relatively safe to say is that an accommodating person dealing with a non-accommodating person will likely receive a smaller share of the gain from the exchange.

Another possibility that may be only subtly different than the first is that Bratton's internal sense of fairness and compensatory justice meant that she felt the men deserved to be left alone. That is, they had worked hard all day, it was late, cold, and getting dark. They wanted to leave. She felt it was unfair for them to exert any more energy to the task of her move given what she imagined their likely compensation would be.

Less benign is the final possibility that she finds herself in an empty house with two or more powerful and impatient men who are complaining about the cold and darkness. The phone has been disconnected and, whatever her decision, the fact is that they now do possess her belongings and should a disagreement arise, there is virtually no way the outcome will be very satisfactory. All of these possibilities could be equated with being cooperative. It is just as likely to characterize them as examples of intimidation, weakness, passivity, or unassertiveness.

To complete this survey of "cooperation" and deal-making possibilities, it is useful to look at the empirical results of two car-shopping experiments conducted by Ian Ayres.³⁸ In two different exercises, Ayres studied the initial and final offers of automobile sellers to shoppers who differed by gender and race.³⁹ Although Ayres' results varied, one critical factor remained the same: black shoppers, both men and women, were consistently made higher initial and final offers.⁴⁰

It is tempting to attribute these outcomes to racial animus and, from a socio-historical perspective, these differences probably ultimately can be traced to a variety of factors including racial animus.⁴¹ From a more current perspective the issue remains, why would sellers—black and white—take the risk of losing profitable sales by consistently making higher initial offers to black shoppers? Two factors seem to play an important role—both dealing with what *sellers* expect to be true about minority buyers. The first is the belief that some shoppers as a group may find the process of bargaining more costly.

37. See Dawn Iacobucci & Amy Ostrom, *Gender Differences in the Impact of Core and Relational Aspects of Services on the Evaluation of Service Encounters*, 2 J. CONSUMER PSYCHOL. 257 (1993).

38. Ian Ayres, *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations*, 104 HARV. L. REV. 817 (1991) [hereinafter Ayres, *Fair Driving*]; Ian Ayres, *Further Evidence of Discrimination in New Car Negotiations and Estimates of Its Cause*, 94 MICH. L. REV. 109 (1995) [hereinafter Ayres, *Further Evidence*].

39. Great efforts were made to make the shoppers appear otherwise "fungible." Ayres, *Fair Driving*, *supra* note 38, at 825–26. More interesting than Ayres' conclusions with respect to final offers are his findings with respect to initial offers. In his initial studies there seemed to be a possibility that the final offer findings were tainted by a research methodology regarding bargaining strategy that essentially locked shoppers into the initial offers. This strategy required shoppers to respond with a "split the difference" counter-offer. Subsequent studies employing both a split the difference approach and one that required shoppers to counter-offer in fixed increments indicate that the bargaining strategy did not significantly affect the outcome. Ayres, *Further Evidence*, *supra* note 38, at 118–19.

40. Ayres, *Further Evidence*, *supra* note 38, at 109.

41. Ayres' results suggest that black shoppers did as poorly with minority owned dealerships and minority sales personnel as they did with white owners and sales personnel. *Id.* at 135–36.

Obviously, if the salesperson's belief is correct, the high-cost bargainer will agree to buy at a higher price. Ayres concluded that this factor could explain the higher prices offered to black women.⁴² The second factor is the sellers' assumptions about the highest price buyers are willing to pay. Here, Ayres found that sellers believed, for example, that black males would pay more than white males, and acted accordingly with respect to initial and final offers.⁴³ Presumably this belief has some basis in fact or profit-maximizing sellers would alter their approaches to bargaining with the currently relatively disfavored buyers.

Now consider all of these examples together. What do the yuppies haggling over a couple of thousand dollars have in common with the poor shoppers who pay three times the average retail price for a freezer; the possibly intimidated woman signing the form in a dark, empty, and cold house; and the likely systematic discrimination against minorities when purchasing automobiles? In all cases, the final bargain increased the welfare of both parties. Moreover, it is a result of their cooperation. This is the economic interpretation. And, in fairness, it is the economic interpretation because that is as far as economics as a discipline can go. It does not hold itself out as offering normative assessments.

One could just as easily note that all of these examples of "cooperation," except perhaps that of the haggling yuppies, are really examples of overreaching, advantage-taking, exploitation, intimidation, passivity or subtle duress. And, in each instance, again putting aside the yuppies, there is an overreaching party and a party who has acquiesced, there is an advantage-taker and the disadvantaged, and there is the coercive party and the coerced party. Unlike the ideal view of deal making in which cooperation means that two parties meet on equal footing to effect an exchange, the examples posed here may be instances in which the exchange and the resulting efficiency *requires* that there be imbalances in power or at least personality differences. In fact, consider the result if the Joneses, Bratton and minority car shoppers act like the ultimatum game player who turns down an increase in his or her material well-being in order to avoid participating in an unfair division of the gain from the exchange. Their lack of cooperation or rebellion may mean going without the freezer, the approval of the movers, or an automobile, respectively. The outcome is that Pareto Superior moves that were available had they cooperated are lost. Their sense of dignity is preserved at the expense of increased material well-being.

Of course, economics has an easy response to the possibility of foregone Pareto Superior moves. Through the use of "psychic income," the argument would be that those Pareto Superior possibilities were anything but that. In fact, as soon as a potential contracting party developed a sense of compensatory justice that prevents the making of the bargain, the bargain is not one that would have enhanced the position of both parties in the first place. Thus, even in the ultimatum game experiments, one cannot say the choice of turning down an offer and receiving nothing is irrational or inconsistent with Paretian concepts of efficiency.

All of this is good enough for economics because economics makes no

42. *Id.* at 137.

43. *Id.* at 138.

claim to having more to say about these issues other than describing them.⁴⁴ Unless law is simple economics dressed up with the patina of morality, this is not sufficient for a law-based response. Instead, legal theory must at least address the dilemma that is presented. The choice is between legitimizing lopsided bargains that may perpetuate societal imbalances and which are arguably the result of revealed preferences and in the interest of efficiency or, through one means or another, delegitimizing the same outcomes.⁴⁵ On its face, it may seem like a simple choice between allocative and distributional goals. For legal theory and practical purposes, it is far more than that. The issue is: do you leave people as you find them or do you begin the process of determining just what accounts for their preferences, the differences in what they find compensatorily just, and the legitimacy of these differences? If these factors are dependent upon and perpetuated by law, then law, because it lays claim to a moral or normative component, must push the analysis another step and look inside Pareto Superiority.

To do this law must look to psychology, sociology, anthropology and, possibly, biology in order to understand its own impact on the ordering of preferences. In the next section, a part of this process is suggested by discussing the huge implications of relative deprivation theory for law. The analysis focuses on relative deprivation because it appears to hold a key to how people form their notions of what is and what is not compensatorily just.⁴⁶

III. RELATIVE DEPRIVATION AND LEGAL RELATIONSHIPS

Close attention to "relative deprivation" grew out of observations of military personnel during the 1940s. One of the earliest and most well-known studies found that higher-ranking officers with *more* privileges were more dissatisfied than military police with fewer privileges.⁴⁷ The basic teaching is that a feeling of satisfaction or dissatisfaction is not a simple function of how one is treated as an absolute matter but of how one fares relative to expectations. For example, a more recent study indicates that company presidents are more likely to be dissatisfied than first-line supervisors earning one-fourth their salary.⁴⁸ As a corollary, what people are willing to ask for and

44. Although those who apply economics to law sometimes want to push economics a bit further. See RICHARD A. POSNER, *THE ECONOMICS OF JUSTICE* (1981).

45. There are many ways of doing this including the use of the doctrine of unconscionability, as in *Star v. Jones*. Laws dealing with capacity as well as a fair amount of consumer protection legislation can be viewed as furthering this interest.

46. My emphasis on relative deprivation is symbolic of a disagreement I have with the conventional wisdom. The conventional wisdom is that markets should be permitted to maximize wealth and redistributions, if any, should be the result of tax and transfer payments. This makes sense but misses the point that a system of redistribution based solely on tax and transfer payments is unlikely to allow people to break out of dependent relationships within the market so as to create their own interpersonal redistributions.

47. SAMUEL A. STOUFFER ET AL., *THE AMERICAN SOLDIER: ADJUSTMENT DURING ARMY LIFE* (1949). See generally Harrison, *supra* note 15, at 460-62; McAdams, *supra* note 15, at 34-37; Faye Crosby & A. Miren Gonzalez-Intal, *Relative Deprivation and Equity Theories: Felt Injustice and the Undeserved Benefits of Others*, in *THE SENSE OF INJUSTICE: SOCIAL PSYCHOLOGICAL PERSPECTIVES* 141 (Robert G. Folger ed., 1984).

48. Edward E. Lawler III & Lyman W. Porter, *Perceptions Regarding Management Compensation*, 3 *INDUS. REL.* 41, 46-48 (1963). See also Ronny Lindstrom & Will H. Moore, *Deprived, Rational or Both? 'Why Minorities Rebel' Revisited*, 23 *J. POL. & MIL. SOC.* 167 (1995); James M. Olson et al., *The Preconditions and Consequences of Relative Deprivation: Two Field Studies*, 25 *J. APPLIED SOC. PSYCHOL.* 944 n.11 (1995).

get is linked to their expectations. Put simply, the person—military police officer, freezer or car buyers, or moving company client—who feels no deprivation is unlikely to ask for more of whatever is at stake.

A formal exposition of relative deprivation includes the following five conditions.

1. Someone else has X.
2. The subject wants X.
3. The subject feels deserving of X.
4. The subject believes obtaining X is possible.
5. The subject does not feel personally responsible for not having X.⁴⁹

This list can be narrowed to wanting X and feeling that X is deserved because items 4 and 5 really deal with the individual's sense of desert.⁵⁰ At heart, relative deprivation involves the process of a person comparing his or her situation, and concluding that he or she is as deserving as the other.⁵¹ Typically, this is a matter of comparing oneself with a selected reference group, but there are other bases of comparison as well.⁵²

One need look no further than the work of Ayres, discussed above, for how the sense of deprivation or lack thereof may manifest itself. For example, one could attempt to explain the results of his experiments either by a lack of seller information⁵³ or by intense racial hatred directed at blacks by both blacks and whites. Neither of these possibilities seems likely and neither is supported by Ayres' research.⁵⁴ Much more likely is the possibility that *buyer* expectations are critical in determining the outcome.⁵⁵ If one feels that it is unfair for blacks to pay hundreds of dollars more for automobiles than whites or for "uneducated" people to pay \$1200 for a \$300 freezer because their expectations mean that those results are viewed as legitimate,⁵⁶ the source of

49. See Faye Crosby, *A Model of Egotistical Relative Deprivation*, 83 PSYCHOL. REV. 85 (1976).

50. Olson et al., *supra* note 48, at 945; Faye Crosby et al., *Relative Deprivation and Explanation: Models and Concepts*, in RELATIVE DEPRIVATION & SOCIAL COMPARISON, 4 THE ONTARIO SYMPOSIUM 17 (James M. Olson et al. eds., 1986).

51. "Equity theory" is a construct that also seems to explain how people form views of fairness. The standard formulation is that people compare the ratio of their "outcomes" to "inputs" with the same ratio for others. When the ratios are equal, a sense of fairness is experienced. See J. Stacy Adams, *Inequity in Social Exchange*, in 2 ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY 267 (Leonard Berkowitz ed., 1965). Equity theory and relative deprivation theory are different in a number of respects but share the importance of social comparisons. They differ in that the sources of a sense of injustice, in relative deprivation, is broader than in equity theory. See Crosby & Gonzalez-Intal, *supra* note 47, at 141-53. See generally Joanne Martin, *The Tolerance of Injustice*, in RELATIVE DEPRIVATION AND SOCIAL COMPARISON, 4 The Ontario Symposium 217 (James M. Olson et al. eds., 1986). Kenneth A. Rasinski, *What's Fair is Fair—Or is It? Value Differences Underlying Public Views About Social Justice*, 53 J. PERSONALITY & SOC. PSYCHOL. 201 (1987).

52. See Crosby & Gonzalez-Intal, *supra* note 47, at 153.

53. This would mean, in the context of the experiments, that sellers assumed black buyers were ignorant of how far the price could be cut and remain profitable.

54. See generally Ayres, *Further Evidence*, *supra* note 38, at 124-28.

55. There is probably no single correct way of stating this proposition. In effect, sellers rely on what they believe to be the expectations of at least a sufficient number of buyers within a group to make adherence to a high price profitable. *Id.* at 126, 138.

56. It is tempting and perhaps too simplistic to attribute these differences to "information problems." Even the willingness to invest in information development presumes a sense that an

that unfairness may lie in the lack of development of a sense of relative deprivation.

Merely stating that those who experience a sense of deprivation are likely to demand and get more of whatever is at stake just leads to a more critical question: Are the reasons for this sense of deprivation or lack thereof "valid"? Making the distinction between "valid" and "invalid" is the job of legal theorists and, lest anyone think this is some kind of bold statement, this is already the job claimed by legal theory in areas ranging from contracts to torts to constitutional interpretation. Here, though, "validity" or "invalidity" turns on the sources of one's expectations.

For example, suppose a black employee in 1950 earns \$3.00 an hour and his white counterpart earns \$4.00 an hour. With full knowledge of the discrepancy, the black employee feels no sense of deprivation because he compares himself to other black workers only. This example can be turned around. Suppose a white worker in the same context is paid the black wage of \$3.00 per hour. She is no more productive than any other worker—black or white—but becomes outraged because she compares herself to white workers only. Is either the "sense of deprivation" of the white woman or the black employee's "satisfaction" based on valid reasons? This is not a question that conventional or any version of economics purports to answer.

If, however, legal theory is to mean anything, it must address the issue of validity. It is hard to see how any serious attempt to do so does not necessitate reference to social, behavioral and other sciences, in order to understand the factors that determine one's capacity to sense unfairness and react to it. In doing so, there are some provocative twists and turns to account for. First, it is again important to note that the fact that others have something—a high salary, a nice home, etc., does not create a sense of deprivation unless one feels that they too "deserve" whatever is at stake. Thus, some people just seem to have a "sense of entitlement" that results in an almost continuous belief that they are deserving of almost anything⁵⁷ while others seem inclined to accept the status quo as being what is fair.⁵⁸ What can be stated with some confidence is that an individual's self-esteem helps determine his or her capacity to feel deprived. For example, low self-esteem is oftentimes related to a sense of responsibility for poor outcomes.⁵⁹ Under the five-item list above, a sense that one is responsible for his or her situation will work against the development of a sense of relative deprivation. As an issue of moral or legal legitimacy, there seems to be little basis for saying that a willingness to take less due to low self-esteem is a "valid reason." Nor does the fact that one comes from a privileged background and has been "taught" he or she need not ever settle for less seem to fit the category of a "valid reason."

There is another twist to the process. How does an individual decide the

improvement is possible and also a risk-taking aggressive attitude.

57. See Harrison, *supra* note 15, at 447.

58. See L. Richard Della Fave, *The Meek Shall Not Inherit the Earth: Self-Evaluation and the Legitimacy of Stratification*, 45 AM. SOC. REV. 955 (1980); Karen S. Cook, *Expectations, Evaluations and Equity*, 40 AM. SOC. REV. 372 (1975).

59. The precise mechanism is not hard to imagine. Low self-esteem means a lower level of self love and a tendency therefore to blame oneself. See generally RICHARD SENNETT & JONATHAN COBB, *THE HIDDEN INJURIES OF CLASS* 20, 28, 249–50 (1972); Della Fave, *supra* note 58, at 962.

relevant reference point? Why would a poor person select other poor people or a black person select only members of a black community? One possibility is to preserve one's psychological well-being. To use a different basis can produce a sense of deprivation and dissonance which can also result in frustration, anger, and sanctions if one is seen as stepping outside his or her class or group.⁶⁰ Recognizing one's worth can be liberating, but it can also be painful.⁶¹ At a subconscious level, it may be important simply to avoid the pain associated with a lack of "cooperation."

A final twist comes from addressing the role of law in the process of forming expectations. There are two angles to take here. The first and narrower is that it is the role of law to evaluate the validity of one's reasons for satisfaction or deprivation.⁶² The second is to recognize the tremendous influence law has in shaping the expectations that lead to these feelings. For example, the court in *Jones v. Star Credit* upheld a finding that the sale of the \$300 freezer for over \$1200 was unconscionable.⁶³ Aside from any other impact, the outcome of this type of decision can be to create in the victorious party a sense that the law has endorsed his or her sense of unfairness, or it has taken a step toward assisting them in developing this sense of injustice. Thus, to the extent that the original result may be connected to a fear of asserting oneself, the decision could even be viewed as therapeutic.⁶⁴

Similarly, legislative efforts in recent years to increase opportunities for members of minority groups may have a similar therapeutic effect on the group or individuals.⁶⁵ This may work through the affirmation of all people and a "lesson" that people are of equal moral worth. To the extent this lesson is taken to heart, the effect of these laws will be to create an increased likelihood of a sense of relative deprivation. Interestingly, this may diminish the "cooperative spirit" that may be seen as consistent with Pareto Superior outcomes and result in less "pliable" people, frustration, and disagreement. Finally, the first few times employers or managers are penalized for sexual harassment or racial discrimination, they may experience a tremendous sense of frustration primarily by relying on the past as the basis for comparison. Eventually, however, as these practices are delegitimized, the sense of deprivation or injustice will most likely wane.

This is not to say that relative deprivation, including that which results from the teachings of law, can be equated with "valid reasons." As noted above,

60. See generally Cass R. Sunstein, *Legal Interference with Private Preferences*, 53 U. CHI. L. REV. 1129, 1152 (1986); JON ELSTER, *SOUR GRAPES: STUDIES IN THE SUBVERSION OF RATIONALITY* 145 (1983).

61. See generally Morton Deutsch, *Awaking the Sense of Injustice*, in *THE QUEST FOR JUSTICE: MYTH, REALITY, IDEAL* 19 (Melvin J. Lerner & Michael Ross eds., 1974).

62. Decisions in contract law about duress, unconscionability, breach, etc., all go to the "validity" of one's disappointments.

63. 298 N.Y.S.2d 264, 266 (Sup. Ct. 1969).

64. See Harrison, *supra* note 15, at 496. See generally DAVID B. WEXLER & BRUCE J. WINICK, *ESSAYS IN THERAPEUTIC JURISPRUDENCE* (1991); Christopher Slobogin, *Therapeutic Jurisprudence: Five Dilemmas to Ponder*, 1 PSYCHOL., PUB. POL'Y & L. 193 (1995).

65. Relative deprivation can be individualized or fraternal. In the latter case, the reaction can be one that seeks to elevate the position of an entire group. See Joanne Martin, *Relative Deprivation: A Theory of Distributive Injustice for an Era of Shrinking Resources*, in 3 RESEARCH IN ORGANIZATIONAL BEHAVIOR 53, 60-67 (L.L. Cummings & Barry M. Staw eds., 1981).

whether informed by overly affirming parenting or legislation, some people may sense injustice where there is none. For example, suppose the white woman worker described above, who is making \$3.00 per hour, is not as productive as anyone else. She may perceive every difference she experiences in society as a result of gender discrimination, not that she needs to work harder. Her newfound sense of entitlement may rule out even addressing the question of "valid reasons" in a constructive manner. On the other hand, some people may engage in self-evaluations that only rarely result in forming this sense of deprivation.

IV. CONCLUSION

Despite the writings of the past thirty years, there remains a question of the extent to which law and economics are complementary disciplines. This question is especially critical when one focuses on the importance of law as a determinant of distributive outcomes. Pareto Superiority would appear, however, to be a concept that at some basic level unites the two areas of study. Although one might prefer a different distributive impact, it seems hard not to accept that an exchange that leaves at least one person better off and no one worse off is at worst unobjectionable. The issue, though, is one of determining what sorts of things go into the sense of being "better off." This requires piercing Pareto Superiority to determine the legitimacy of the factors that result in a sense of justice or a sense of injustice or deprivation. Economics is of very limited use in this analysis.⁶⁶ Legal analysis, if it is to be anything other than an empty vessel, must draw on the teachings of psychology, sociology and other fields in order to engage in this inquiry.⁶⁷ Unlike economics, the appearance of mutual assent is only the beginning of this analysis.⁶⁸ Indeed, one of the outcomes of legal analysis may be the realization of the value of conflict and disagreement as a means to achieving just, as opposed to merely efficient, outcomes.

The process is complicated by the fact that law, in all of its forms, helps shape the expectations of people. The law is not merely a reaction to injustice but creates standards by which individuals may feel wronged. Thus, law is not merely reactive; it informs, shapes, and teaches. In this sense it can play the role of creating in those less advantaged a sense of deprivation that is required for the type of assertive autonomy that permits individuals to liberate themselves.

66. Economics retains some of its usefulness here for descriptive purposes.

67. See, e.g., Paul J. Albanese, *The Nature of Preferences: An Exploration of the Relationship Between Economics and Psychology*, 8 J. ECON. PSYCHOL. 3 (1987).

68. Obviously, law and legislation range far beyond allocations that achieve Pareto Superior outcomes. The analysis here focuses on the process of agreeing to exchanges.